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June 5, 2000

VIA HAND DELIVERY

ENTERED
Office of the Secretary
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The Honorable Vernon A. Williams
Secretary
Case Control Unit
Attn.: STB Ex Parte 582 (Sub-No. 1)
1925 K Street, N.W.
Washington, DC 20423-0001

RE: STB Ex Parte No. 582 (Sub-No. 1), *Major Rail Consolidation Procedures*

Dear Secretary Williams:

Enclosed please find the original and 25 copies of the Reply Comments of The Kansas City Southern Railway Company in the above-captioned proceeding. A copy of the Reply Comments is also enclosed on a 3.5-inch disk in MicroSoft Word format.

Please acknowledge receipt of these Reply Comments by file-stamping the extra copy and returning it to the person making the filing for return to me.

Sincerely,

William A. Mullins/TJH

William A. Mullins

cc: All known parties of record

BEFORE THE
SURFACE TRANSPORTATION BOARD

Ex Parte No. 582 (Sub-No. 1)

MAJOR RAIL CONSOLIDATION PROCEDURES

ADVANCE NOTICE OF PROPOSED RULEMAKING

REPLY COMMENTS OF THE
KANSAS CITY SOUTHERN RAILWAY COMPANY

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June 5, 2000

BEFORE THE
SURFACE TRANSPORTATION BOARD

Ex Parte No. 582 (Sub-No. 1)

MAJOR RAIL CONSOLIDATION PROCEDURES

ADVANCE NOTICE OF PROPOSED RULEMAKING

REPLY COMMENTS OF THE
KANSAS CITY SOUTHERN RAILWAY COMPANY

The Kansas City Southern Railway Company ("KCS"), by its counsel, hereby provides the Surface Transportation Board ("STB" or the "Board") with its Reply Comments in *Major Rail Consolidation Procedures*, Ex Parte No. 582 (Sub-No. 1). By decision served March 31, 2000 in the above docketed proceeding,[1] the Board solicited public comment on modifications to its regulations at 49 C.F.R. Part 1180, Subpart A (49 C.F.R. §§ 1180.0—1180.9), which govern proposals for rail consolidations. In response to the *ANPR*, KCS filed the "Comments of The Kansas City Southern Railway Company" ("Comments") on May 16, 2000. These Reply Comments are filed in furtherance of those Comments.

As the Board is aware, approximately 120 parties accepted the Board's invitation to comment on ways in which the Board's existing merger regulations could be improved. As might be expected, the comments reflect a variety of viewpoints, from those who would introduce sweeping regulatory reforms (both within and outside of the merger context) to those

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[1] *Major Rail Consolidation Procedures*, Ex Parte No. 582 (Sub-No. 1), Slip op. (STB served March 31, 2000) ("*ANPR*").

who propose modest changes so as to basically maintain the status quo. After reviewing and considering the merits of all of these comments, KCS believes that one theme unites them all: *the importance of getting it right.*

A host of significant issues currently face the railroad industry and its shippers. The regulations under which mergers are reviewed and approved have a profound effect on the ability of railroads to provide safe, accessible, and competitive transportation services. Through the changes to be implemented in this proceeding, the Board will do nothing short of sculpting the structure of railroading in the 21st century.

In these Reply Comments, KCS has elected not to address many of the significant issues debated at length by other commentors. Although those issues may be of some importance (there are many proposals that KCS opposes and many that KCS supports), KCS does not intend in these Reply Comments to comment on each and every proposal. Instead, in this filing, KCS has attempted to draw from those filings the general themes and proposals.

Although several of KCS' proposed modifications were unique or provided a new perspective on an old issue, the comments filed by the other parties are remarkably similar to the seven proposals put forth by KCS. As a result, these Reply Comments will demonstrate that all of KCS' proposals are consistent with the thoughts of a significant number of commentors. Indeed, the changes suggested by KCS represent a unique middle ground between the divergent and, in some instances, irreconcilable positions taken by other commentors, indicating that the Board should carefully consider including all of KCS' proposals in its proposed rules. By doing so, the Board would be carefully balancing the interests of all parties, and garnering the broadest possible support for its proposed rules.

I. A SIGNIFICANT MAJORITY OF COMMENTORS SUPPORT A CHANGE IN THE BOARD'S CURRENT APPROACH REGARDING "THREE TO TWO" ISSUES

The Board has sought public comment on whether its "assessment of 'three-to-two' effects should be reflected in [its] new merger rules, or whether this issue is best left to a case-by-case examination based on the individual circumstances of each case, as it has been in the past." *ANPR* at 9. KCS, supported by Dr. Curtis M. Grimm,[2] submitted comments that analyzed the Board's past approach to assessing potential reductions to competition at three to two locations and examined the economic literature regarding the adverse effects of reductions in the number of competitors from three to two. Based upon this analysis, KCS concluded that the Board's approach has failed to remedy the adverse effects created by three to two reductions. KCS and Dr. Grimm therefore proposed a policy change to the existing merger regulations. That proposal calls for a presumption in favor of preserving the number of independent competitors serving a relevant market, thus shifting the burden to the applicants to disprove that presumption.

As expected, a significant number of commentors expressed similar, if not identical, concerns and proposed similar remedies. Specifically, other commentors joined KCS in observing that the Board has effectively adopted a "two is enough" policy which presumptively favors three to two reductions. *See* Alliance of Automobile Manufacturers ("AAM") at 10-11 ("We are concerned that, as a matter of practice, there may be a *de facto* presumption at the STB to approve a three-to-two merger on the theory that a choice between two railroads is enough."); Committee To Improve American Coal Transportation ("IMPACT") at 19 ("In approving the UP/SP merger and the NS/CSX acquisition of Conrail, the Board embraced a view that the

[2] Professor Curtis M. Grimm, a noted economist in the transportation industry, serves as the Chair of Logistics, Business, and Public Policy at the College of Business and Management, University of Maryland.

existence of two railroads in a market - or even in a large portion of the United States - was enough to provide adequate intramodal competition, so the reduction in the number of rail competitors in a market from 3 to 2 was no cause for concern and did not require a remedy through competition-restoring conditions."); National Grain and Feed Association ("NGFA") at 13-14 ("As far as NGFA is aware, past efforts by shippers to object to rail mergers that would reduce competitive options from three to two uniformly have been rebuffed by the Board (or by the Interstate Commerce Commission before it)."); Ohio Rail Development Commission ("ORDC") at 5 ("In particular, the STB failed to serve its stated macro vision by summarily rejecting any claim that the reduction of competitors from three to two (3 to 2) had absolutely no impact on competition."); and PPL Electric Utilities Corporation and PPL Montana LLC at 22 ("PPL") ("Shippers going from service by three railroads to two get no relief."). The Board should carefully consider the uniform concerns reflected above and adopt KCS' proposed rule in its planned Notice of Proposed Rulemaking.

Given the Board's *de facto* presumption against a finding of anticompetitive harm from reductions of competition in three to two markets, one must ask why the Board should change that policy. What's wrong with the Board's current policy? Why aren't two railroads enough? KCS' Comments contained a detailed discussion of this issue and in reviewing the comments of others, the answer is simple: while two railroads are better than one, it is the existence of a third railroad in a market that enhances competition and prevents anticompetitive behavior by the two dominant carriers. This view, and the need to revisit the Board's approach to three to two issues, was supported not only by KCS and Dr. Grimm, but by numerous shippers, rail carriers, and other economists. *See* Alliance for Rail Competition at 3 ("Economic theory—borne out by the experience of many rail customers—holds that...two railroads simply are insufficient to ensure adequate competition."); AAM at 10-11 ("Our industry's experience has been that consumers (and ultimately their suppliers) benefit most where there is healthy competition between several suppliers."); IMPACT at 22-23 ("Experience shows how the loss of a third carrier can significantly degrade a rail-dependent shipper's competitive position."); Dow Chemical Company ("Dow") at 17 ("This was a clear example of the pro-competitive impact that a third competitor can have on an otherwise complacent second competitor. Duopolies enhance the risk that competitors will become comfortable in their current positions and choose not to compete too aggressively against the dominant carrier in one market out of concern that they will invite similar challenge to their dominance in another market."); Keokuk Junction Railway Co. ("KJRY") at 5-6 ("When there are only two competitors they tend, in perfectly legal and non-collusive ways, to split the business. Both know they cannot legally, or physically, handle all the business, and effective competition becomes difficult, if not impossible. There must be at least three competitors to give effective competition a fighting chance."); Wheat, Barley & Grains Commissions ("WBGC") at 6 ("[WBGC] feel[s] that a strong argument can be made that the minimum number of rail carriers to establish truly competitive service to all rail customers should be three equally strong carriers. The presence of only two equally strong rail carriers in a region many times leads only to efficient collusion."); and PPL at 23 ("It should no longer be assumed that 3-to-2 shippers suffer no loss of competition."). KCS and Dr. Grimm are thus voices in the chorus holding the view that, if left unchanged, the Board's existing policy on three to two issues will inevitably lead to two railroads in this country (much as that policy has led to the current state of regional duopolies) and that when two railroads dominate a market, corridor, or section of the country, they provide poorer service, higher rates, and less competition than in areas where they face a credible third competitor.

This view was further confirmed by the thoughtful statements presented in this proceeding by Mr. Nelson, Dr. William Tye, and Mr. Wolfe. All of these testifying witnesses supported revising the Board's current approach to three to two issues and adopting a policy that preserves competition at three to two locations. In their statements accompanying the comments submitted by IMPACT, Mr. Nelson and Dr. Tye explain why three competitors compete more vigorously than do two. In support of this view, Dr. Tye references several economic studies that demonstrate the importance of a third competitor to sustain meaningful competition. *See* IMPACT, V.S. Tye at 95-98 ("The empirical evidence demonstrates that removal of the crucial third competitor would have far-reaching consequences for the competitiveness of the railroad industry. The pricing and service problems characterizing the current state of the railroad industry, with fewer, larger competitors, will only be exacerbated by the elimination of another competitor."). Similarly, Mr. Wolfe echoed many of Mr. Nelson and Dr. Tye's comments. Wyandot Dolomite, Inc., V.S. Wolfe at 4-5 ("I urge the Board to step back and recognize . . . that a merger leaving behind only two competitors of disparate financial strength and resources may well not be in the public interest. The Board should discard its 3-2 policy and replace it with a searching analysis on an individual basis.").

Like KCS, these commentors and economists believe it would not be in the public interest to have only two large railroads serving the entire United States. They fully support the notion that there is no basis for a policy disregarding three to two competitive reductions in rail mergers and that moving from three competitors to two in a market leads to an inexorable diminution of competition and to higher rates for shippers. Independently of KCS, these shippers, economists, and other commentors reached the same conclusion as KCS; *i.e.*, the Board needs to revise its approach to three to two issues.

The only economist to submit a somewhat different view was Dr. Vellturo, whose testimony was proffered by CN . Given the fact that CN is currently attempting to pursue a merger, it is not surprising that CN would offer a witness taking this position. KCS principally disagrees with Dr. Vellturo's claim that the Board historically has been following a case-by-case approach to the three to two issue. Vellturo V.S. at 20 ("The Board should continue to employ a case-by-case approach in future transactions."). As stated above, the Board has not truly been following a case-by-case approach to imposing conditions in three to two markets to preserve competition, but has employed a *de facto* presumption against a finding of competitive harm in three to two situations. Indeed, the Board, for at least the past ten years, has not imposed a condition on the basis that three to two was a problem.

Other than Vellturo's mischaracterization of past Board practice, the substance of his statement actually supports the fact-based case-by-case approach to three to two effects which KCS advocates and which the KCS-proposed rule accomplishes. Vellturo V.S. at 20 ("Industry characteristics such as cost structure; characteristics of transportation products and services such as heterogeneity; characteristics of transactions such as secrecy of service contracts; as well as intermodal competition and source/destination-based competition, are just a few of the factors that may have a material bearing on the likely competitive effects of a 'three-to-two' combination (or any other structural change in the number of rail participants). Given the nature of these factors, a fact-intensive review of 'three-to-two' issues is warranted."). As detailed in the statement of Dr. Grimm attached to KCS' Comments, the primary factor to consider when evaluating any structural change in the number of rail participants is the market shares of the merger partners in the relevant market and the change in market concentration resulting from the consolidation.

Not surprisingly, most Class I rail carriers expressed support for the Board's current policy with respect to three to two issues. *See* Burlington Northern and Santa Fe Railway ("BNSF") at 29; Canadian National Railway ("CN") at 6; Canadian Pacific Railway ("CP") at 14; CSX Transportation ("CSX") at 21; and Norfolk Southern ("NS") at 32-33. Some of these commentors expressed complete opposition to any blanket rule prohibiting transactions that may result in three to two situations. KCS agrees that there should be no such blanket prohibition on future mergers or the creation of three to two situations. Indeed, there may be instances in the future where the public interest justifies a reduction in intramodal competition from three to two and thus the Board's approach should review the merits of each situation on a case-by-case basis. However, KCS does not believe that the present policy is in fact a case-by-case approach. Instead, as outlined in KCS' Comments, the review of relevant precedent indicates a *de facto* rule the other way -- a presumption that three to two reductions in competition are not a problem.

KCS' proposal to create a presumption in favor of preserving intramodal competition and shifting the burden to the merger applicants to provide a rationale for any proposal that seeks to reduce intramodal competition was supported through similar ideas expressed by other commentors. *See* AAM at 10-11 ("The STB should modify its rules to clearly establish that there will be no presumption in favor of approving a merger where the merger will reduce the number of rail companies serving an area from three to two."); IMPACT at 5 ("3-to-2 reductions in rail competition should be presumed to have an anticompetitive effect."); *Id.* at 24-25 ("At a minimum, Board merger policy should put the burden on the proponents of a merger to show specific reasons why a reduction of the number of railroads in a particular market will not have anticompetitive effects; general references to intermodal, product or geographic competition should not suffice."); *See also id.* V.S. Nelson at 62; KJRY at 5 ("The...Board should give greater weight to arguments of competitive harm in situations where the number of rail carrier alternatives would be reduced by merger from three to two."); NGFA at 14 ("At the very least, the Board should require the merging railroad to assume the burden of proving that any market realizing a service reduction from three carriers to two will not suffer any adverse competitive impacts."). These commentors, representing a diverse array of shippers and railroads, all came to a conclusion similar to that reached by KCS: the Board should implement a more realistic case-by-case approach to three to two issues, and should shift the burden of proof in future merger cases to the merger applicants. In order to justify an unconditioned three to two reduction in competition, a merger applicant should be required to demonstrate that such a reduction is in the public interest.

The notion that three to two reductions in competition can never be a problem found absolutely no support in the comments. Likewise, the record does not support any argument that KCS' proposed changes to the Board's analysis of three to two issues would be so prohibitive as to stifle the development of further rail efficiencies. Instead, the record is replete with comments demonstrating that efficiencies can be achieved through alliances, marketing agreements, joint dispatching arrangements, and other forms of voluntary coordination short of merger. *See* American Short Line and Regional Railroad Association at 5-6 ("Section 1180.1(c) should be amended to include '[t]he Board will consider whether the benefits claimed by applicants could be realized by means other than the proposed consolidation that would result in less potential harm to the railroad network, shippers and the public'."); Port Authority of New York and New Jersey at 4-5 (Section 1180.1(a) should be amended to provide that "carriers must also demonstrate that the competitive enhancements and improved service (to be achieved through the proposed merger) could not be accomplished by means other than the proposed consolidation.");

The Procter & Gamble Company at 4 ("In situations where merging railroads do present a plan with data for their claims of public interest benefits, the STB should require an analysis from the merging railroads on what prevents these benefits from being achieved without a merger. Concepts such as marketing alliances with other railroads, cooperative operating practices, and improved information systems should be addressed in this analysis."); NS at 14-15 ("[T]he current balanced structure of the railroad industry may make it possible for the major rail systems to achieve through inter-carrier marketing agreements, alliances and other coordination short of formal merger at least some of the benefits that previously may have been attributed to railroad mergers and therefore considered as a public benefit in the merger review process."); and Union Pacific Railroad ("UP") at 18 ("[M]ergers may impair benefits achievable through alternative arrangements.").

To the extent carriers believe further efficiencies in the rail industry are needed, or indeed necessary, alternative methods exist for obtaining these efficiencies. As the Alliance Agreement among KCS, CN and Illinois Central ("IC") and the testimony provided in many ICC/STB merger cases proves, single-line efficiencies can be achieved without mergers and without anti-competitive reductions in competition. Furthermore, as noted above, the KCS proposal does not prohibit mergers or prohibit efficiencies that can be gained by mergers, but simply creates a rebuttable presumption against reducing intramodal competition as the result of a merger.

In conclusion, despite the fact that the parties did not have an opportunity to review each other's proposals, a significant majority of commentors came to the same conclusion as KCS with respect to the three to two issue — reductions in the number of intramodal competitors from three to two can have significant adverse effects and should not be allowed absent a compelling public interest justification. While some commentors suggested adopting a blanket rule prohibiting reductions in competition from three to two and other commentors supported the Board's current approach, KCS' proposal strikes an appropriate balance between these two positions.

By creating a rebuttable presumption that disfavors the elimination of intramodal competition, the KCS proposal restores the importance of competition in merger analysis without eliminating the need for a case-by-case analysis of the competitive effects of a given transaction. Given the broad support for a change in the Board's current approach to three to two issues, the KCS proposal should be adopted by this Board and included as one of the rules published for comment in the Board's October Notice of Proposed Rulemaking.

II. KCS' PROPOSAL TO REQUIRE THE DISCLOSURE AND JUSTIFICATION OF SERVICE RESTRICTIONS CONTAINED IN MARKETING, HAULAGE AND TRACKAGE RIGHTS AGREEMENTS ENJOYS SIGNIFICANT SUPPORT

In the *ANPR*, the Board indicated a willingness to consider enhancing, and not merely preserving, competition in its review and approval of future rail mergers. *ANPR* at 7. As further detailed in its Comments, KCS believes that the Board's consideration of competitive issues is both timely and appropriate, and that while drastic measures such as forced open access for every solely-served shipper could lead to unfortunate economic consequences, more moderate means exist to provide competitive options while preserving franchise value.

In its Comments at 21-32, KCS brought to the Board's attention the problem of restrictions limiting the competitiveness of conditions imposed in prior mergers. The Board and the ICC have traditionally placed conditions on mergers in an attempt to preserve the competitive options that existed for shippers in certain markets and corridors pre-merger. Often, these conditions were framed quite narrowly, so as to avoid any possibility of making any shipper better off than it was before the merger and thereby contained significant restrictions limiting the scope of the condition and the railroad's ability to provide a "fix" for the competitive harm. The downside of placing restrictions on conditions, of course, is that they limit the party exercising the conditional rights from providing the complete array of competitive services that it might provide in the absence of the restrictions. In short, restrictions on conditions suppress the rail network's competitive potential.

The merger review process, which already involves a detailed consideration of traffic flows, operating characteristics, and economic circumstances, would be an appropriate venue for the Board to review the possibility for increasing competition. One limited method of implementing increased competition in future mergers would be to reconsider, each time a new merger is proposed, the appropriateness of relevant past restrictions placed on merger conditions. By making the review of the scope of past conditions a mandatory element of each merger, the Board could gradually implement its revised vision of the public. Rail carriers would have to consider the potential impact of increased competition at some of their on-line facilities as one element of weighing the value of their proposed combination. The increased market power sought in some rail mergers would potentially come with an increased cost.

Surprisingly, it does not appear that other parties, in their initial comments, have identified the value of revisiting restricted conditions in their proposals for modification of the existing merger regulations. KCS realizes that methods currently exist for parties to seek review of the appropriateness of conditions imposed in prior mergers; *i.e.*, a petition for reopening or filing comments in the context of an oversight proceeding. However, whatever the value of these alternative review methods, KCS believes that its proposed rule presents two distinct advantages over existing remedies. First, the KCS rule would shift the burden of proof over to the party seeking to continue restrictions placed on otherwise viable competition. If the *ANPR* truly does represent a change in the Board's consideration of the wisdom of enhancing competition, then a good place to start would be to place the onus of establishing the need for restrictive conditions on the party seeking to maintain those conditions. Second, KCS' proposed rule would reduce the administrative burden incurred in challenging old restrictions. Instead of forcing aggrieved parties to open a new subdocket of the prior merger docket, the new rule would allow the same issues to be examined with a more restricted filing in a subsequent merger, all without eliminating or restricting the availability of existing remedies. Finally, the review of the continued public interest justification of previously imposed conditions is most appropriate in the context of the Board's consideration of the cross-over and cumulative effects of a merger. In that context, the Board can examine both the cause and effect of such previously restricted conditions.

Although parties did not have the opportunity to comment on KCS' proposal before it was filed, KCS firmly believes that it represents an appropriate balance between parties seeking to entirely revamp the competitive landscape and parties working toward maintenance of the status quo. For example, as the Board is aware, the Chemical Manufacturers Association and the American Plastics Council proposed that all merging carriers be required to provide a competitive shipping option for all captive shippers. Similarly, shippers such as BASF Corporation, E. I. Du Pont De Nemours and Co., and McKinley Paper have all urged the Board to consider the adoption of an "open access" standard in rail mergers. On the other hand, a number of other parties, such as NS and CP, clearly oppose open access, and have urged the Board to resist using mergers as an opportunity to expand competitive access. *See, e.g.*, NS at 41 (terming forced open access "catastrophic"); and CP at 11 ("CPR does not believe that it would be in the public interest for the Board to alter fundamentally its approach to competitive issues in rail merger cases…".).

KCS' proposal is firmly grounded between these two extreme positions. Unlike the proposals to grant open access in mergers, the KCS proposal would not invite widespread operating changes, financial turbulence, or disputes over what truly constitutes "open" access. However, unlike the "do nothing" position suggested by other carriers, the KCS modification would provide parties with an opportunity, in the context of a future merger proceeding, to increase competition in certain markets and corridors. KCS' proposal to modify previously restricted merger conditions would enhance the competitive abilities of many shortline and regional railroads, all without a stark departure from existing operating patterns.[3] Moreover, because the elimination of restrictions would be accomplished only as future mergers are decided, these goals would be accomplished on a gradual basis. An abrupt, wholesale change (possibly yielding unanticipated or undesired results) would not be needed.

Finally, and perhaps most importantly, the modification to the existing merger regulations proposed by KCS would not require any fiat as to the general usefulness or necessity of restrictions placed on merger conditions. Many conditions would continue to function entirely as they had before, and some conditions would be revised to reflect the evolving notion of the public interest. Indeed, the Board would retain the flexibility to impose restrictions on conditions imposed in future mergers if those conditions were found to be consistent with the

[3] In most cases, the carrier upon which the operating restriction has been imposed already is operating in the market and the lifting of the Board imposed restriction would not significantly change the operating patterns. For example, The Texas Mexican Railway Company ("Tex Mex") already operates both northbound and southbound trains in and out of Houston, but is prohibited from picking up local Houston northbound traffic, or dropping off local Houston southbound traffic, due to a Board-imposed restriction. If that restriction were removed, very few operational changes would be needed in order for Tex Mex to fully serve the Houston market.

public interest. As opposed to proposals which require the Board to essentially overrule many years of precedent, KCS' proposal merely urges that the Board revisit prior conditions from a more modern viewpoint. In this manner, the consistency of the Board's precedent will not be impaired.

III. PRESERVATION OF THE BENEFITS CLAIMED FROM PRIOR MERGERS IS CONSISTENT WITH THE COMMENTS OF MANY PARTIES

In the *ANPR,* the Board indicated that it was inclined to eliminate the "one case at a time" rule found at 49 C.F.R. § 1180.1(g) ("Section 1180.1(g)"). *ANPR* at 5. While the elimination of this rule and the consideration of "downstream effects" may provide the Board with a more complete assessment of the impacts of a rail merger, KCS believes that the preservation of benefits (promised or achieved) in prior mergers is an even greater pressing concern. In other words, the Board should concern itself with assuring the continuation of the fruits of past combinations before the potential impacts of future combinations are considered.

In order to address this concern, KCS has proposed a modification to Section 1180.1(g) that would refocus the rule on establishing in every future merger proceeding a minimum threshold rule that the preservation of benefits claimed in the course of prior mergers should be preserved unless public interest justifications require their elimination. The modified regulation would require merger applicants to establish that the benefits they claimed from prior mergers will not be adversely impacted if approval of their most recent merger proposal is granted or, if they are, that a greater public interest concern is served. Although preventing harm to competition has always been a focus of the Board's merger review, KCS' rule would, for the first time, place the burden of establishing the absence of harm to past benefits directly on the merger applicants. In this manner, merging parties will give earlier, and perhaps more thorough, attention to maintaining the benefits of prior mergers, responding parties will have a better idea of how a new merger proposal will impact the benefits they enjoyed in prior mergers, and the Board's efforts to assure that mergers remain in the public interest will not be undone in a scramble for still further mergers.

The proposal to make merging parties responsible for preserving the benefits of their prior mergers is consistent with the written comments of a host of other parties, all of whom expressed concern that prior merger benefits be preserved, or that monitoring be imposed to make sure that those benefits are realized in the years following a merger. For example, an array of diverse parties (including railroads, state transportation agencies, shippers, and unions) are so concerned with the realization and preservation of merger benefits that they have called for mandatory monitoring of alleged benefits. Included among such parties are CP at 18 ("The STB should revise its regulations...to support the measurement of...benefits with data sufficient to enable interested parties (and the Board) to critically evaluate both the likelihood and the magnitude of the public benefits flowing from the proposed transaction."); Iowa Department of Transportation at 1 ("The Board should develop a standard monitoring and reporting process to review the progress of the merger in achieving the estimated benefits and impacts on service to shippers...[oversight] authority provides the Board with the opportunity to monitor the progress of railroads in assuring the benefits put forward in justification of consolidation."); the Society of the Plastics Industry, Inc. at 12 ("SPI respectfully submits that carriers which have been granted merger approval publicly account for their progress in achieving the benefits projected, as well as whether they are improving or even maintaining service."); Empire Wholesale Lumber Co. at 7 ("Projected benefits...should be fit into a timeline by the merger applicants and should be monitored by the Board."); and Rail Labor Division of the Transportation Trades Department

AFL-CIO at 3 ("RLD supports an express requirement for monitoring and post-consummation assessment of Transactions."). All of these parties support the concept that merging railroads must be held accountable for the merger benefits they promise. Merging railroads cannot be allowed to walk away from such promises once the merger is approved, nor should they be allowed to dismiss promised benefits once another merger opportunity presents itself.

In addition to comments supporting the concepts of monitoring and ongoing responsibility for providing promised merger benefits, several parties also identified the importance of determining how alleged merger benefits will be impacted by future transactions. National Industrial Transportation League ("NITL") at 10 ("In addition to the Board's undertaking a more searching analysis of the claimed benefits of a particular transaction, [NITL] believes that, in all future merger proceedings, the Board should require the applicant carriers to include an analysis of the claimed benefits of the applicants' immediate past merger(s) (as long as they took place within the last eight years) with a comparison of the actual results of that prior transaction at the end of each of the five years subsequent to the consummation of the prior transaction."); Finger Lakes Railway Corp. at 16 ("FGLK recommends that the merger proponents be required as part of the merger requirements to succinctly quantify the benefits of the proposed combination and the resulting public benefits, and how those benefits might be affected by likely subsequent responses. We believe the Board should then encourage the public to comment specifically on the anticipated downstream effects of the proposed merger in that phase of its merger consideration.") and ORDC at 10 ("First, ORDC believes that the STB should create a process through which it officially assesses whether the benefits promised by railroads in a merger actually occur. The merging railroad should not be allowed to participate in any other merger proceeding until such time as the STB officially declares that the projected benefits of the last merger have been achieved.") These comments all highlight the importance of considering not just the realization of promised benefits, but also the likely impact of subsequent events on those benefits. While these parties came at the issue from slightly different angles and therefore proposed different solutions, the comments of all of these parties reflect the need to achieve promised benefits long after a transaction is approved. Indeed, all of these comments are consistent with the fundamental premise to KCS' proposed modification, that the burden should be placed on merging parties to establish that subsequent transactions will not interfere with the benefits they previously projected.

KCS' proposed rule for preserving prior benefits has one distinct advantage over the approaches suggested by virtually every other commentor: instead of merely impacting future mergers, the KCS rule focuses on benefits which have already been promised by merger applicants, which have been scrutinized and accepted by the Board or its predecessor as justification for approving the merger, and which have been relied upon by the public. The success of the merger applicants in achieving these promised benefits can be tested. By focusing on the preservation of past benefits, the Board will improve the overall benefits provided by future mergers.

In summary, the principle that merging carriers should be responsible for the benefits they promise enjoys a broad base of support. Railroads, state transportation agencies, shippers, and unions have all expressed concern about whether merging railroads are actually realizing the benefits on which their mergers are based. KCS believes that the rule it has proposed, which would require railroads to preserve the benefits they touted in past merger proceedings, is a moderate, reasoned, balanced approach to the idea of holding railroads accountable for promised merger benefits. The proposed rule would not unduly burden future mergers or make them less likely to occur. Rather, it would hold railroads to their promises. In addition, KCS believes that it would make railroads more realistic in their projection of anticipated merger benefits.

IV. KCS' PROPOSAL TO REQUIRE THE DISCLOSURE AND ANALYSIS OF THE IMPACTS OF NEGOTIATED AGREEMENTS IN MERGER PROCEEDINGS IS CONSISTENT WITH THE COMMENTS OF OTHER PARTIES

Currently Board policy does not require merger applicants to submit negotiated agreements or settlement agreements to the Board for review or approval. Even though settlement agreements have the potential to significantly impact traffic flows, service capabilities and competitive routings, applicants are not required to present any analysis or public interest justifications for any settlement agreement reached as part of a merger proceeding, nor are they required as a matter of course to disclose the terms of such agreements. In practice, merger applicants voluntarily submit only those settlement agreements which will assist them in securing the Board's approval for the merger transaction. However, the fact that not all settlement agreements are filed with the Board prevents the Board from making a fully informed decision on all impacts of a major transaction.

KCS' proposed rule would set a procedural method under which applicants would be required to submit copies of all settlement agreements for the record, subject to standard protective order conditions in Board proceedings. Parties would then have 30 days for discovery and to file evidence and comments responding to the settlements. The rule would not require the Board to approve or disapprove settlement agreements. Rather, the rule assures a complete record that will give the Board the full picture with which to decide and protect the public interest in the transaction.

KCS, like other parties, does not want to discourage privately negotiated settlement agreements in mergers. *See* National Railroad Passenger Corporation ("Amtrak") at 13-14 (advocating that the Board's policy of encouraging settlements and negotiated agreements be incorporated in the Board's regulations). However, encouraging settlement agreements is consistent with KCS' proposed rule that would ensure that the Board would have a full record with which to accurately weigh the public benefits and the potential risks of a proposed merger. The desire for a more complete record in merger proceedings was supported by the following commentors: Amtrak at 9 (requesting that the merger application provide more information on passenger service issues); BNSF at 4 (advocating that additional evidence and analysis be provided by merger applicants in the initial merger application); CSX at 13-18 (advocating that additional evidence to be provided by merger applicants in the initial merger application); United States Department Of Transportation ("USDOT") at 3 ("Only by significantly more rigorous analysis will the Board be able to weigh the potential public benefits of a merger against any risks it might pose."); NITL at 3 (request that the Board require more reporting by merger applicants); NS at 64 (advocating that additional evidence, including but not limited to the immediate production of 100% traffic tapes, be provided by merger applicants); Western Canadian Shippers' Coalition at 3-4 and Canadian Pulp and Paper Assoc. at 4 ("Without such data, the full effects of the proposed transaction cannot be adequately determined. Shippers need a full record to make meaningful assessments regarding railroad choices which will be available to them."). While these comments did not specifically focus on settlement agreements, the goal of these commentors is the same goal as contained within the KCS rule – the more information the Board and the public have with respect to the effects of a proposed merger, the better the decision making process will be.

KCS' proposed rule seeking full disclosure of settlement agreements is fully consistent with a recent ruling by the Board in the *Conrail* proceeding. *See CSX Corp. et al., and Norfolk Southern Corp. et al. – Control and Operating Leases/Agreements – Conrail Inc., et al.*, Finance Docket No. 33388 (Sub-No. 91) Decision No. 2 (STB served May 30, 2000). In Decision No. 2, the Board granted a shipper's request to see a copy of a trackage rights agreement that was negotiated between the merger applicants and another party in response to a Board-imposed condition. The Board granted the shipper's request to see the agreement because the Board found that the shipper would find it difficult to develop and present evidence concerning the effectiveness of a merger condition without viewing the agreement. Decision No. 2, Slip op at 2. It is apparent that the Board understands the importance of having a full record available for making important decisions and no decision could be more important than determining the public benefits and potential harms of a proposed rail merger.

Just a few days ago, the Board issued a decision which squarely demonstrates why the merger review process would be improved if KCS' proposed rule requiring the disclosure of settlement agreements in merger cases was adopted. *See Union Pacific Corp. et al – Control and Merger – Southern Pacific Rail Corp. et al.*, Finance Docket No. 32760, Decision No. 89 (STB served June 1, 2000) ("Decision No. 89"). It is apparent from the Board's Decision No. 89 that UP believed it had a "settlement agreement" with a shipper while the shipper did not believe it waved any Board imposed merger rights. In addition, although not free from dispute, the underlying filings in the case indicate that UP and BNSF had an undisclosed deal to treat the shipper as "unique" from other similarly situated shippers. *See* Union Pacific Railroad Company's Response to AmerenUE's Petition for Clarification and Enforcement of Merger Conditions, UP.SP-374, Public Version at 6, dated Feb. 8, 2000; Reply of AmerenUE to

Additional Issues Raised by UP in Its "UP/SP-374" Response, Public Version at 3, dated Feb. 23, 2000. Nonetheless, the Board found the alleged "settlement agreement" in no way narrowed the rights that the shipper would have otherwise been entitled to under the Board's decision approving the merger.[4] *See* Decision No. 89, Slip op ___. If KCS' proposed rule had been in place during that merger, the "settlement agreement" and the separate deal would have been disclosed and analyzed on the record. KCS' proposed rule would thus eliminate the Board's difficult task of determining, post-facto, whether a settlement agreement narrowed other public benefit conditions in any way because there would be no undisclosed deals.

KCS supports the Board's past precedent of encouraging negotiated agreements and settlement agreements. KCS also supports the disclosure of these agreements and of permitting parties the right to analyze and comment on a settlement agreement. KCS' proposed rule would provide the Board with a complete record with which to evaluate the public benefits and risks of the proposed merger. The Board should adopt KCS' proposal for disclosing and discussing the impact of negotiated agreements or settlement agreements in merger proceedings and include KCS' proposed rule in the Board's October Notice of Proposed Rulemaking.

V. A BALANCED APPROACH TO IMPLEMENTING CHANGES IN RECIPROCAL SWITCHING ACCESS HAS BROAD SUPPORT

In its *ANPR*, the Board stated that "the time has come to consider whether we should alter our rail merger policy to place a greater emphasis on enhancing, rather than simply preserving, competition." *ANPR* at 7. One of the areas that the Board specifically cited for review was reciprocal switching and specifically whether mandatory reciprocal switching should be

[4] The Board found that the shipper was entitled to rights under the "omnibus clause" of the BNSF Agreement as a "2-to-1" shipper, as those terms are defined in *UP/SP* Decision No. 44.

considered in the context of a merger for competition enhancement. *Id.* KCS believes that its Comments provide the appropriate balance for a proposed rule on reciprocal switching in the context of a merger.

KCS' proposed rule would require merger applicants to disclose any reciprocal switching arrangements that were canceled within 24 months of the filing of the applicants' notice of intent to merge. The rule would then create a rebuttable presumption favoring reinstatement of the previously canceled reciprocal switching upon request by a party in the merger proceeding. While technically the rule could be viewed as enhancing competition, in reality, the rule merely restores competition to shippers who previously had such competition but lost that competition due to their plants being closed to reciprocal switching just prior to an announced merger. In that respect, the rule provides fundamental "two to one" protections for a shipper or receiver who would have otherwise lost the two to one protections because one or all of the applicants had canceled the availability of access to another railroad via reciprocal switching prior to the filing of the merger application. Unlike the concept of mandatory reciprocal switching for all shippers as a means of enhancing competition when considering a merger, KCS' proposal calls for a relationship between the shipper's predicament and the merger under consideration. It calls for restoring competition which may have been eliminated in anticipation of a merger. As a result, KCS' proposed rule provides an appropriate middle ground of preserving and enhancing competition for those shippers that recently lost access to another carrier without over-reaching and mandating new forced access for all captive shippers, including captive shippers who have never had access to another rail carrier.

The idea of restoring competition where it had previously existed, like the KCS proposed reciprocal switching rule, was advocated by the May 16th comments of the State of New York

("New York"). New York's comments advocate a much broader rule than KCS has proposed, but the goals are the same. Essentially, New York asks the Board to restore all forms of previously lost competition without providing any definition of those access rights or any time limit for the reinstatement. New York at 9-10. Without intending criticism of New York's proposed rule, KCS points out that KCS' own, more moderate approach would both identify affected shippers/receivers and specify a time frame whereby applicants and all other parties can reasonably calculate the effect that the rule would have on the merging entities. KCS believes that the ability of applicant carriers, as well as shippers, to be able to accurately determine the impact a rule will have on a merger transaction is important to the health of the rail industry. To impose a broad rule for reciprocal switching, such as proposed by New York, while well intentioned, could have the effect of deterring all future rail mergers, which KCS does not believe should be summarily curtailed.

The comments filed by CP also provide support for the ideas embraced in KCS' proposed rule on reciprocal switching. CP's comments state that "impos[ing] a switching condition at locations where reciprocal switching agreements existed prior to the merger...as the Board did in the recent *Conrail* proceeding ... is fully consistent with the Board's long-standing policy of preserving pre-merger competition." CP at 16. KCS' rule goes beyond CP's comments by advocating the enhancement of competition for previously canceled reciprocal switching in broader terms than the Board imposed in the *Conrail* proceeding. As explained in KCS' Comments, KCS' proposed rule would most likely have reinstated the switching for the shippers in Buffalo who were denied relief in *Conrail*. Nevertheless, CP's recognition of the appropriateness of protecting pre-existing reciprocal switching agreements is consistent with KCS' proposed rule.

In the USDOT comments, USDOT recognized the problem of canceled reciprocal switching prior to a merger. Specifically, USDOT noted that "[at USDOT] outreach meetings with various groups, there were claims that prior to announcing mergers, carriers canceled switching in terminal areas without notifying affected shippers. As a consequence, shippers who previously had multiple carrier options may be (sic) find that they are captive to one carrier." USDOT at 14-15, n. 8. Nevertheless, USDOT advocated granting forced open switching in terminal areas instead of permitting the Board to restore previously canceled reciprocal switch because in USDOT's view this would be easier for the Board. *Id.* While mandating forced reciprocal switching for all shippers in terminal areas might be easier for the Board to administer, such a rule simply bears no relationship to the impact of individual mergers and, as such, has no place in the Board's merger regulations. What USDOT is suggesting is of a much broader scope and warrants a proceeding dedicated to its complete exploration and evaluation. Indeed, USDOT seems to agree when it urges "the Board to reject options covering issues that would address wider, non-merger related matters." (*See* USDOT at 3). KCS' proposed rule, on the other hand, bears a direct relationship to the Board's consideration of any individual merger transaction.

Other commentors have suggested that the Board should adopt the limitless mandatory reciprocal switching rule. The majority of comments on reciprocal switching consist primarily of a supportive repetition of the Board's suggestion to review whether mandatory reciprocal switching at an agreed-to fee should be considered in the debate over enhancing competition. Most of these commentors do not provide any additional support or explanation for their proposed new rule.

Furthermore, many of the commentors have requested the Board to go beyond the context of a merger and impose mandatory reciprocal switching or the Canadian model of "interswitching" access invariably in all situations. The Board should oppose the imposition of any new rules that would affect the rail industry outside the context of a merger as exceeding the scope of this rulemaking.

As stated in its initial comments, KCS opposes the adoption of a broad rule mandating reciprocal switching at all locations, for all shippers, whether in the context of a merger or outside of the context of a merger. KCS believes such a broad rule would detrimentally change the Board's long-standing precedent and irreparably harm rail carriers. KCS agrees with parties such as USDOT, NS, BNSF and CN that the proper place to address non-merger related or industry-wide issues is in a separate rulemaking, or such issues are better left up to the marketplace. *See* USDOT at 3 ("[U]rge the Board to reject options covering issues that would address wider, non-merger related matters."); NS at 48 ("Whether particular shipper facilities should be open to switching is a matter that should be left to the marketplace."); BNSF at 24 ("The Board should conduct a separate rulemaking on an industry-wide basis."); CN at 30-31 (The Board "should open a separate docket for that purpose, and invite comments on the merits of access for the entire industry, outside of the merger context."). To undertake changing the Board's rules outside the context of a merger and mandating forced reciprocal switching at all locations, and thus basically overruling the *Midtec* decision, would go far beyond the bounds of this rulemaking. Instead the Board should adopt KCS' balanced rule of reinstating previously canceled reciprocal switching in the context of a merger.

VI. A NUMBER OF PARTIES RECOGNIZE THE DISTINCTIONS WHICH SUPPORT APPLICATION OF THE BOARD'S "MAJOR" MERGER REGULATIONS TO ONLY THE LARGEST RAILROADS

As KCS pointed out in its Comments, the composition of the nation's Class I railroads can be divided among the "Big Six" (UP, BNSF, CSX, NS, CN and CP) and KCS. KCS' annual revenues, while qualifying it as a Class I carrier, are approximately one-quarter of those of the next largest Class I railroad. More pertinent to the current discussion, KCS' market reach (generally between Kansas City and the Gulf of Mexico) is far more limited than that of any other Class I carrier, each of which has direct access to Chicago and at least one ocean. The mergers and mega-mergers of the last twenty years have left KCS, once a rather typically-sized Class I carrier, an energetic but undersized contender on a field of giants. Although KCS is currently the only small Class I carrier, several other large Class II railroads will shortly qualify as Class I carriers due to their increased revenues.

In light of the changed circumstances caused by the mergers of the last few decades, KCS believes that it is not appropriate for the Board's most extensive level of merger scrutiny (applied only to "major" mergers) to apply to an agreed merger between KCS and any other Class I carrier. Indeed, given the limited scope of KCS' system relative to the size of the remaining Class I carriers and absent the fact that KCS is classified as a Class I carrier, a merger of KCS into one of those systems would not ordinarily be a "major" transaction. This is because the potential areas where competition would be impacted are very limited, the effect of the acquisition cost on the ledgers of a large Class I carrier would be small, and the prospect for integration problems from merging KCS into virtually any other system would also be small. Therefore, KCS believes that as long as such a transaction was negotiated to the satisfaction of all parties, a merger of KCS (or any small Class I carrier) into a large Class I carrier could be adequately reviewed under the Board's "significant" regulations.

KCS must express the following caveat with respect to this proposal, however: any merger requires intense cooperation. Should KCS be taken over in a hostile fashion by another Class I carrier, or should a smaller, privately held railroad be forced into such a transaction through economic leverage, the potential for operating and service problems resulting from such a takeover is significant because the motivation for extensive cooperation would be lacking. Furthermore, when a large railroad seeks to acquire control of a smaller carrier against its will, its motives as they relate to competition should be subjected to serious scrutiny by the Board. Therefore, KCS' proposed new rule qualifies the reclassification of small Class I/large Class I mergers to recognize that if such mergers are to be effected against the will of the smaller carrier, the merger should take place under the Board's more stringent "major" classification.

KCS' proposed rule, under which small Class I/large Class I mergers would ordinarily be treated as "significant" transactions, has already been supported by at least one railroad which also may soon have a stake in this issue. In its comments, Wisconsin Central Ltd. ("WCL"), which is currently a Class II railroad but may soon qualify as a Class I carrier as a result of its increasing revenues, stated:

> "...simply replacing the existing "major" merger rules of 49 C.F.R. § § 1180.0-1180.9 with new rules would sweep in other transactions technically classified as "major" (that is, involving two or more Class I carriers) but plainly of a radically different character. That would be the case, for example, with a transaction involving the KCS, or other smaller railroad that achieved Class I status subsequent to adoption of the new rules. There is an obvious and fundamental distinction between Class I, transcontinental mega-carriers and these much smaller entities, and similarly a distinction in how they should be treated for merger purposes.
>
> Regardless of one's position on the need for new rules covering the "final" round of rail mega-mergers, the STB cannot ignore the fact that there is now a gap of close to $5 billion between the smallest Class I railroad and most other railroads in the class. As part of this proceeding, or as a separate rulemaking proceeding, the STB should consider redefining the revenue threshold for Class I railroads or, certainly, at a minimum, the definition of what major transactions should be encompassed in the new rules. The positions expressed in Ex Parte No. 582, and the potential remedies that the STB may ultimately propose in Ex Parte No. 582 (Sub-No. 1), will have vastly different impacts on railroads that seek to be multi-billion dollar, transcontinental railroads and those that continue to remain regional – even where transactions involving the latter may fall into what the STB now considers to be "Class I" or "major" transactions.

WCL at 5-6 (footnotes omitted). KCS fully supports WCL's views on this issue.

As these statements amply demonstrate, concern over the reach of the Board's regulations governing "major" transactions extends beyond KCS. Like KCS, WCL is concerned that the "major" grouping casts too broad a net, effectively grouping carriers which have precious little in common. Because there is no reason to believe that the merger of a small Class I railroad with one of the Class I behemoths would generate the competitive or service issues arising from a "marriage of equals," WCL and KCS agree that agreed-to mergers involving smaller Class I railroads do not require application of the Board's "major" transaction scrutiny.

In addition to the comments of WCL, which directly seek reconsideration of the STB's use of its designation of all Class I mergers as "major," a number of other parties have provided indirect support for KCS' position. Specifically, certain parties have lent support for the concept that KCS and the other regional railroads which will soon qualify as Class I railroads do not have the market reach or competitive impact of the "Big Six." *See* Bentonite Performance Minerals at 3 ("We are now left with four major railroads in the United States…".); Dow at 6 ("The Board should take steps to require carriers to maintain open gateways for all major routings. This is particularly important over the Mississippi River gateways because shippers in both directions currently have a choice of two carriers."); and Williams Energy Services at 9 (discussing generally the impact of a regional duopoly on rail traffic north of the Rio Grande River). All of these parties emphasize the dichotomies that currently separate KCS from the remaining Class I railroads. Further, their comments reaffirm the facts demonstrated by KCS in its Comments: KCS technically qualifies as a Class I railroad because of its revenues, but in operation and market reach, it functions much more like a regional rail carrier.

Because of the recognized differences which separate KCS (and all other regional railroads which might soon become Class I railroads) from the remainder of the Class I railroads, the Board should modify its regulations to reclassify small Class I/large Class I mergers to "significant" status, unless such mergers are proposed against the corporate will of the smaller carrier, in which case the protection of the public interest requires that they be processed under the Board's "major" classification.

VII. MANY PARTIES SUPPORT THE DISCLOSURE AND REVIEW OF PAPER AND STEEL BARRIERS IN RAILROAD MERGER APPLICATIONS

In the *ANPR*, the Board sought comments on how the issues of paper and steel barriers, which currently limit the competitive operation of many shortline and regional railroads, should be reflected in the merger rules. In its initial comments, KCS analyzed the effects of paper and steel barriers on a consolidating industry and concluded that, under certain circumstances, the Board's existing policy fails to adequately safeguard the ability of shortline and regional carriers to effectively compete. Given the reduced number of rail carriers resulting from decades of mergers, policies that ensure that shortline and regional carriers can effectively compete are essential to preserving intramodal rail competition. KCS proposes that merging rail carriers be required to disclose and justify all paper and steel barrier impediments that prevent shortline and regional railroads from interchanging and competing over their systems, and to analyze such restrictions in light of changes in competitive circumstances that the proposed merger would create. Importantly, KCS does not recommend that the Board adopt a blanket rule that disallows agreed-upon commercial arrangements between parties. Instead, KCS' proposal would change such paper barriers only in the event that the effects of paper and/or steel barriers are inconsistent with the public interest, and then only in the context of future merger proceedings.

As the Board is aware, many parties have submitted comments in this proceeding which address paper and steel barriers. Although most commentors believed that such barriers pose roadblocks to effective competition, the methods by which these parties would regulate paper and steel barriers were diverse. *See* American Farm Bureau Federation at 2-3 (Encouraging the Board to examine whether the currently common practice of imposing paper and steel barriers on regional and short-line railroads is in the public interest with regard to safeguarding rail service.); Dakota, Minnesota & Eastern Railroad Corporation at 7 ("[W]e actually prefer simply doing away with all paper barriers of merger applicants across the board."); Eastern Coal Transportation Association at 13 ("ECTA supports the revision of Board merger policies to eliminate contractual barriers to interchange -- ('paper barriers') -- that are not demonstrated to be reasonable, alternative financing mechanisms."); WBG at 7 ("Rail mergers should be re-opened in the event rail competition is curtailed or lost, and the regulator should condition all rail mergers to enhance, not just maintain, competition in the future. Options such as…[the] elimination of paper and steel barriers…must be available to mitigate anti-competitive effects of mergers."); IMPACT at 14 (The Board should require merger applicants to include back-up plans for service failures, allowing independent carriers to provide service, including the right to override paper barriers); Montana Rail Link, Inc., I&M Rail Link, LLC, and Southern Railway of British Columbia at 2 ("The Companies urge the Board to revise the merger procedures, so that…merger applicants are required to identify 'paper barriers' they have in place with connecting class II and class III carriers…".); Transportation Intermediaries Association at 9-10 (The Board should re-think its policy regarding paper barriers from both an economic and competitive perspective; the Board should be able to evaluate, in a particular circumstance, whether a Class I railroad has already received the reasonable economic benefit of a paper barrier such that further continuation of the restriction is inappropriate or whether restrictions that may have been relatively harmless when there were many Class I carriers are harmful in a world where two Class I railroads predominate). Although these comments reflect different viewpoints, they all agree with KCS in its conclusion that, while the Board should honor commercial arrangements between parties, the Board must be aware of existing or proposed paper and steel barriers and have the ability to modify or remove such barriers in instances where they are not consistent with the public interest.

Many of the commentors in this proceeding have proposed the outright elimination of paper and steel barriers, a position not advocated by KCS. *See* ARC at 4 ("One of the most immediate means of beginning to correct the unintended consequences of past merger policy would be the elimination of paper and steel barriers…".); Consumers United for Rail Equity at 5 ("CURE asks the STB to eliminate all 'paper barriers' that arbitrarily restrict full interchange rights for Class II and Class III railroads."); Du Pont at 9 ("Paper barriers, established at the time of the short line spin-off as a condition of sale, constrain the economic potential of new short lines and are clearly not in the public interest."); Edison Electric Institute at 8 ("The Board should adopt a presumption against any new 'paper' or 'steel' barriers, and should conclude that prior ones are presumptively contrary to public policy."); Farmrail System, Inc. at 3 ("[T]he Board should stimulate competition by requiring merging Class I carriers to eliminate paper barriers restricting competition…".); Oklahoma Department of Transportation at 8 ("In any new merger, the applicants should be required to rescind all paper barriers."); Ports of Seattle, Tacoma, and Everett at 11 ("Each Class I carrier involved in the transaction shall eliminate all Paper Barriers with short line or regional carriers to which it is a party."); PPG Industries, Inc. at 3 ("So called 'paper restrictions'…which reduce or restrict competitive access should be removed."); NITL at 4 ("The Board should revise its approach to paper barriers restraining competition by short line carriers, to eliminate such barriers in the future, and permit the selective amendment of past barriers on specified showings by the short lines.").

Unlike the latter commentors, KCS does not propose any substantive changes to the Board's position announced last year, in which it deferred consideration of relief from paper and steel barriers until the Rail Industry Agreement has had a chance to operate. *Review Of Rail Access And Competition Issues*, Ex Parte No. 575, Slip op. (STB served March 2, 1999). KCS simply asks the Board to require merger applicants to disclose the scope of existing or proposed steel and paper barriers. Disclosure will enable the Board to fulfill its responsibilities and determine whether the paper and steel barriers at issue are consistent with the public interest in light of merger-caused changes in competitive circumstances. As mentioned above, KCS only recommends that certain steel or paper barriers be eliminated or modified when such barriers are inconsistent with the public interest. Given the broad support for a change in the Board's current policy with respect to steel and paper barriers, KCS' moderate proposal of disclosure should be adopted by this Board and included as one of the rules published for comment in the Board's October Notice of Proposed Rulemaking.

VIII. SUMMARY OF REPLY COMMENTS

In conclusion, KCS has proposed seven modifications to the Board's merger regulations, and each of those proposed modifications marks a balanced approach to ensuring that railroads provide shippers with responsive, dependable, and competitive service. In addition, each of the recommended changes is consistent with the positions taken by a host of parties participating in this case. More importantly, KCS' proposed rules strike an appropriate balance to preserve, and in some instances to restore, competition, without gutting the financial stability of the railroad industry.

None of the seven proposed changes guarantees to KCS, or to any other carrier, any traffic. They do not ask the Board to adopt an abrupt reversal of any long-established policies. Nor do they return railroads to the oppressive regulatory framework that existed before the Staggers Act. Indeed, KCS believes that these seven changes are a modest but critical step towards avoiding reregulation of railroads.

Respectfully submitted,

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CERTIFICATE OF SERVICE

This is to certify that on this 5th day of June, 2000, I caused the foregoing "Reply Comments of the Kansas City Southern Railway Company" in the Ex Parte No. 582 (Sub-No. 1) proceeding to be served upon counsel for all known parties of record by first class mail, postage prepaid, or by more expeditious means.

Tom Healey

Thomas J. Healey